From: Scott, Dukes
To: Patel, Swati; Baker, Josh
Subject: Wells Fargo report on SCANA
Date: Tuesday, June 7, 2016 8:30:10 AM
Attachments: 06052016 Wells.pdf
ATT00001.txt

Attached is a Wells Fargo report regarding SCANA issued following a meeting with ORS. The report includes this statement re. ORS:

We have visited with the ORS on a number of occasions over the last several years and have always found the Staff to be one of the most thoughtful and well-versed regulatory bodies.

Thank you for all your support. Dukes

June 5, 2016

WELLS FARGO SECURITIES

Equity Research

SCANA Corporation

SCG: Takeaways From The Palmetto State

Outperform

Sector: Regulated Electric Utilities
Market Weight

- **Summary.** On 6/2, we met with senior executives from SCG and, separately, members of the South Carolina Office of Regulatory Staff (ORS). The primary topic of conversation was the new nuclear development, particularly in light of SCG's recent decision to opt for the Fixed Price Option (FPO). That said, we also discussed Public Service North Carolina Energy's (PSNC) attractive growth outlook and SCG's financing plans (addressed in the body of the note). Overall, we came away incrementally positive on the SCG story and, most importantly, continue to believe there is strong support for new nuclear in South Carolina. We reiterate our Outperform rating and increase our 12-18 month valuation range to $78-79/share from $74-76/share.

- **ORS Meeting.** While we think the unique set of circumstances around the FPO will require scrutiny, we believe there is a path for SCG to reach another constructive settlement agreement with the ORS. The $850MM cost increase, roughly $500MM of which is directly related to the FPO selection (relative to the $6.8B approved on 10/27/15), clearly raised some eyebrows and the ORS will understandably seek to better understand the drivers and rationale for the higher cost. However, the ORS stressed that their diligence efforts will be consistent with what is prescribed under the state's 2007 Base Load Review Act (BLRA). Specifically, the BLRA allows SCG to recover higher costs unless the ORS (or other parties) can show that the company acted imprudently.

- **New Nuclear Update.** SCG's management appears pleased with Fluor, who took over as project manager for the nuclear project from Chicago Bridge & Iron (CBI) in late-2015. It sounds like the overall process is far more stream-lined with process improvements occurring and potential problems identified at a far more rapid pace than in the past. SCG expressed confidence in the target substantial completion dates of August 2019 (Unit 2) and August 2020 (Unit 3).

- **Reiterate Outperform.** We continue to believe SCG offers investors an attractive risk/reward proposition. First, we believe SCG's 5-yr EPS CAGR will be towards the high end (if not above) the company's 4-6% guidance, which represents a premium growth rate relative to peers (4-5%) - our 2016-20E EPS are $4.00, $4.20, $4.60, $4.95 & $5.40. Second, on a P/E basis, shares trade at a sizeable 13% discount relative to peers (regulated electrics with market caps between$5-20B) on our 18E EPS of $4.60. We believe the discount will erode as the perceived risk of the new nuclear development subsides. This will be dependent upon (1) a constructive outcome for SCG's pending FPO filing at the South Carolina Public Service Commission and (2) execution on the construction.

Valuation Range: $78.00 to $79.00 from $74.00 to $76.00
Our $78-79/sh valuation range is based on a P/E multiple (apply a ~5% discount to the 17E Regulated Electric median of ~18X to our 18E of $4.60) and DDM analyses. Risks include regulatory and construction.

Investment Thesis:
We view SCG's 10+% P/E discount to be excessive as the above-average nuclear construction risk is partially offset by above-average EPS growth and a supportive regulatory environment, including timely BLRA recovery of new nuclear CapEx.

Valuation Range Change

	2015A	2016E		2017E	
EPS		**Curr.**	**Prior**	**Curr.**	**Prior**
Q1 (Mar.)	$1.39	$1.23 A	NC	NE	
Q2 (June)	0.69	0.70	NC	NE	
Q3 (Sep.)	1.04	1.06	NC	NE	
Q4 (Dec.)	0.69	0.97	NC	NE	
FY	$3.81	$4.00	NC	$4.20	NC
CY	$3.81	$4.00		$4.20	
FY P/EPS	18.7x	17.8x		16.9x	
Rev.(MM)	$4,380	$5,189		$5,433	

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters
NA = Not Available, NC = No Change, NE = No Estimate, NM = Not Meaningful
V = Volatile, ♠ = Company is on the Priority Stock List

Favorable weather versus normal provided a $0.08 benefit in 2015.
SCG's '16 weather-normalized EPS guidance is $3.90-4.10. Q1'16 mild weather hurt electric margins ($0.05) and led to a $0.06 EPS decline at GA sub.

Ticker	SCG
Price (06/03/2016)	$71.15
52-Week Range:	$49-72
Shares Outstanding: (MM)	142.9
Market Cap.: (MM)	$10,167.3
S&P 500:	2,099.13
Avg. Daily Vol.:	889,151
Dividend/Yield:	$2.30/3.2%
LT Debt: (MM)	$6,034.0
LT Debt/Total Cap.:	51.8%
ROE:	10.0%
3-5 Yr. Est. Growth Rate:	6.0%
CY 2016 Est. P/EPS-to-Growth:	3.0x
Last Reporting Date:	04/28/2016 Before Open

Source: Company Data, Wells Fargo Securities, LLC estimates, and Reuters

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Please see page 6 for rating definitions, important disclosures and required analyst certifications
All estimates/forecasts are as of 06/05/16 unless otherwise stated.

Takeaways from SC Visit

On 6/2, we ventured to Columbia, SC to meet with senior executives from SCG and, separately, members of the Office of Regulatory Staff (ORS). While the primary topic of conversation was the new nuclear development, particularly in light of SCG's recent decision to opt for the Fixed Price Option (FPO), we also caught up on PSNC Energy's attractive growth outlook and SCG's financing plans. Overall, we came away from the meetings incrementally positive on the SCG story and, most importantly, continue to believe there is strong support for new nuclear in South Carolina.

The Office of Regulatory Staff

We met with Executive Director Dukes Scott along with a number of senior members of the ORS's staff. We view the ORS as the most influential party in South Carolina regulatory proceedings. The ORS is tasked with balancing the interests of customers with the financial integrity of the state's utilities as well as the need for economic development in the state. We have visited with the ORS on a number of occasions over the last several years and have always found the Staff to be one of the most thoughtful and well-versed regulatory bodies.

The discussion focused on SCG's May 26 filing with the South Carolina Public Service Commission (SC PSC) electing the FPO. ***Our key takeaway from the meeting was that while the unique set of circumstances around the FPO will require scrutiny, we believe there is a path for SCG to reach another constructive settlement agreement with the ORS.***

Key points:

- **Optics** - The SC PSC's approval of SCG's previous request to increase the gross construction cost to $6.8B (the SC PSC originally approved a $6.3B cost in 2009) on 9/10/15 and SCG's subsequent announcement on 10/27/15 that the cost was projected to further increase to $7.1-7.6B clearly caused some concerns for the ORS. At the time of SCG's announcement, we worried that the optics around the announcement (particularly considering the timing) could raise some eyebrows in SC. We believe our concerns were well-founded.

- **Scrutiny** - The ORS stressed that the FPO filing is unlike any other of SCG's nuclear-related filings and will, therefore, require a different ***type*** (not level) of scrutiny. Specifically, the ORS will seek to better understand the drivers and rationale behind the significantly higher gross construction cost.

- **Prudency** - Importantly, the ORS stressed that their diligence efforts will be consistent with what is prescribed under the state's 2007 Base Load Review Act (BLRA). Specifically, the BLRA allows SCG to recover higher costs unless the ORS (or other parties) can show that the company acted imprudently. Thus, the burden of proof for disallowance of costs is on the intervenors, not the utility. The imprudence test does not extend to the actions/performance of other members of the Engineering, Procurement & Construction consortium (i.e. Westinghouse, CBI, etc.). Ultimately, we believe SCG will be able to demonstrate the rationale, customer benefits, etc. of the FPO.

- **Timeline** – Following the filing of SCG's petition on 5/26, the various parties (including SCG) will file testimony over the next couple of months and a final order from the SC PSC is due on or before November 28th. In terms of a potential settlement with the ORS (and possibly other parties), we believe the timing would be in the August-October timeframe, likely prior to the start of hearings. However, an exact procedural schedule has yet to be established.

SCANA

We met with Chairman & CEO Kevin Marsh, CFO Jimmy Addison, COO Stephen Byrne, Rusty Harris - President & COO of PSNC and Kenny Jackson – Senior Vice President of Governmental & Regulatory Affairs.

Key points:

- **Nuclear Development Update** – SCG's management appears pleased with Fluor, who took over as project manager for V.C. Summer Units 2 & 3 from CBI in late-2015. It sounds like the overall process is far more stream-lined with process improvements occurring and potential problems identified at a far more rapid pace than in the past. SCG expressed confidence in the target substantial completion dates of August 2019 (Unit 2) and August 2020 (Unit 3).

- **The Virtues of the FPO** – Management believes that the benefits of the FPO more than justify the incremental costs. These benefits include (1) greater cost certainty, (2) higher potential liquidated damages from Toshiba, which owns Westinghouse, in the event of non-performance (SCG's portion is $372MM vs. $86MM previously), (3) a meaningful completion performance bonus of $300MM (SCG's portion is $165MM) that better aligns Toshiba's interests with SCG's – interestingly, Toshiba receives the completion bonus as long as the units qualify for the production tax credits (PTCs) even if the qualifying date is moved beyond the existing 1/1/21 cut-off date and (4) greater specificity around what constitutes a change in law (Westinghouse/Toshiba is not responsible for higher costs associated with a qualifying change in law).

- **Gas Growth** – While PSNC represents a relatively small portion of SCG's consolidated earnings power (~10%), the gas utility is experiencing a period of strong rate base growth driven, in large part, by pipeline replacement projects – including the ongoing $325MM replacement/expansion of a 73-mile pipeline.

  PSNC's pending base rate case includes a proposal to implement an Integrity Management rider (already approved for PNY, a neighboring North Carolina-based utility). If approved, the rider should better allow PSNC to earn the company's allowed ROE as 50-75% of the company's projected capex would be covered by the mechanism. In 2015, PSNC earned a 9.16% ROE vs. an allowed ROE of 10.6%. By our calculations, a 100 bps improvement in the earned ROE would add $0.03 to annual EPS and projected rate base growth should add another $0.05 annually during the period 2016-18.

- **Financing Plans** – SCG's existing budget, which is premised on new nuclear gross construction costs of $6.8B, contemplates ~$250MM of new equity issued in 2017/18 via the company's internal programs. The FPO results in an incremental cost of $850MM. Consistent with prior communications, management indicated that the FPO would require additional equity but they did not foresee any needs in 2016. While we believe it is not unreasonable to assume 50% of the incremental cost is financed with equity, management understandably would like to minimize new equity issuances right in front of potentially large free cash flow (FCF) generation once the nuclear units are completed and capex potentially returns to more normal levels.

Our Thesis

We continue to believe SCG offers investors an attractive risk/reward proposition. First, we believe SCG's 5-yr EPS CAGR will be towards the high end (if not above) the company's 4-6% guidance, which would represent a premium growth rate relative to the projected peer group growth rate of 4-5%. Our 2016-20E EPS are $4.00, $4.20, $4.60, $4.95 & $5.40.

Key assumptions include:

- new nuclear capex consistent with the FPO filing (~$7.7B of gross construction costs for the entire project) and a schedule consistent with the current timeline (Unit 2 in service by August 2019 and Unit 3 by August 2020),
- reasonable regulatory treatment on the incremental new nuclear costs relative to the $6.8B approved in October 2015,
- new equity of $550MM issued during the period 2017/18 and
- earned ROEs for SCG's non-new nuclear operations of 9.0-9.5%.

While SCG's credit metrics are at the low end of investment grade for a regulated utility risk profile (FFO/Debt is ~13% and Debt/EBITDA is ~5x), once the nuclear units are in operation SCG should be in position to rapidly improve the balance sheet if deemed prudent.

By 2021, we estimate SCG could generate annual FCF (after dividends) of $500-600MM predicated on (1) $850MM of net income, (2)$650MM of depreciation & amortization (3) $175MM of net deferred tax benefits – SCG is not expected to be a federal cash tax payer for several years once the units are placed in service; though a portion of the tax benefits (production tax credits for new nuclear) are expected to be flowed directly back to customers via the fuel clause, (4) annual capex of $600-700MM and (5) dividend requirements of $450MM. <u>By our calculations, if SCG deployed all of the FCF to reduce debt, within two years the company's FFO/Debt and Debt/EBITDA metrics would improve to 15%+ and ~4x, respectively.</u> Please refer to Figure 1 for the pros and cons underlying our positive thesis.

Figure 1: SCG's Pros & Cons, In Our View

SCG Outperform Thesis: Pros & Cons	
Features	**Considerations**
Strong Rate Base Growth Potential → 2016-20 CAGR of ~9% → Driven by new nuclear development → Cash recovery of nuclear costs during construction → FPO de-risks nuclear project	Elevated Execution & Construction Risk (Nuclear) → Nuclear development subject to delays & cost overruns → Fluor is 3rd project manager since project commenced → Toshiba / Westinghouse experiencing financial difficulties
Constructive Political / Regulatory Environment → Nuclear-related legislation (BLRA) affords protection → BLRA indicative of strong state support for nuclear → Track record of settlement agreements with ORS	Credit Metrics at Low End of Investment Grade → FFO/Debt and Debt/EBITDA at 13% and 5X+ → Substantial capital markets needs during '16-18
Strong EPS & Cash Flow Outlook Outlook → Potential for 6%+ annual EPS growth ('16-20) → Project $500-600M of annual FCF post-nuclear build	
Attractive Relative Valuation → ~10% P/E discount to peers on our 18E EPS	

Source: Wells Fargo Securities, LLC

From a valuation perspective, share remain attractive relative to Regulated Electric peers, in our view. On a P/E basis, shares trade at a sizeable 10% discount relative to the (all-cap) Regulated Electric peer group on our 18E EPS of $4.60. In addition, shares trade at a13% discount relative to regulated peers with market capitalizations between $5-20B (see Figure 2). This peer group excludes companies pending take-outs (ITC, TE & WR). We believe the valuation discount will erode over time as the perceived risk of the new nuclear development subsides. This will be dependent upon (1) a constructive outcome for SCG's pending FPO filing at the SC PSC and (2) execution on the construction.

Figure 2: SCG Trades at a Material Discount to Peers

	Ticker	Price 6/03/2016	Market Cap. ($ Bil.)	P/E 2017E	P/E 2018E	P/E 2019E	Div. Yld.	16E Payout
SCANA	**SCG**	**$71.28**	**$10.2**	**17.0x**	**15.5x**	**14.4x**	**3.2%**	**58%**
Regulated Electric Utilities ($5-20B Market Cap)								
Alliant Energy	LNT	$38.23	$8.7	19.1x	17.9x	17.1x	3.1%	63%
Ameren	AEE	$50.10	$12.2	18.2x	16.7x	15.7x	3.4%	68%
CMS Energy	CMS	$42.75	$12.0	19.6x	18.3x	17.1x	2.9%	61%
Eversource Energy	ES	$56.30	$17.9	17.9x	16.8x	15.6x	3.2%	59%
Pinnacle West	PNW	$75.68	$8.4	17.9x	17.6x	17.0x	3.3%	63%
WEC Energy	WEC	$61.45	$19.4	19.6x	18.6x	17.6x	2.7%	57%
Median			**$12.1**	**18.7x**	**17.8x**	**17.1x**	**3.1%**	**62%**
SCG Premium / (Discount) to Peers				***-9%***	***-13%***	***-16%***		
All-Cap Regulated Electric Utility Median Multiples				**17.9x**	**17.2x**	**16.0x**	**3.2%**	**61%**
SCG Premium / (Discount) to All-Caps				***-5%***	***-10%***	***-10%***		

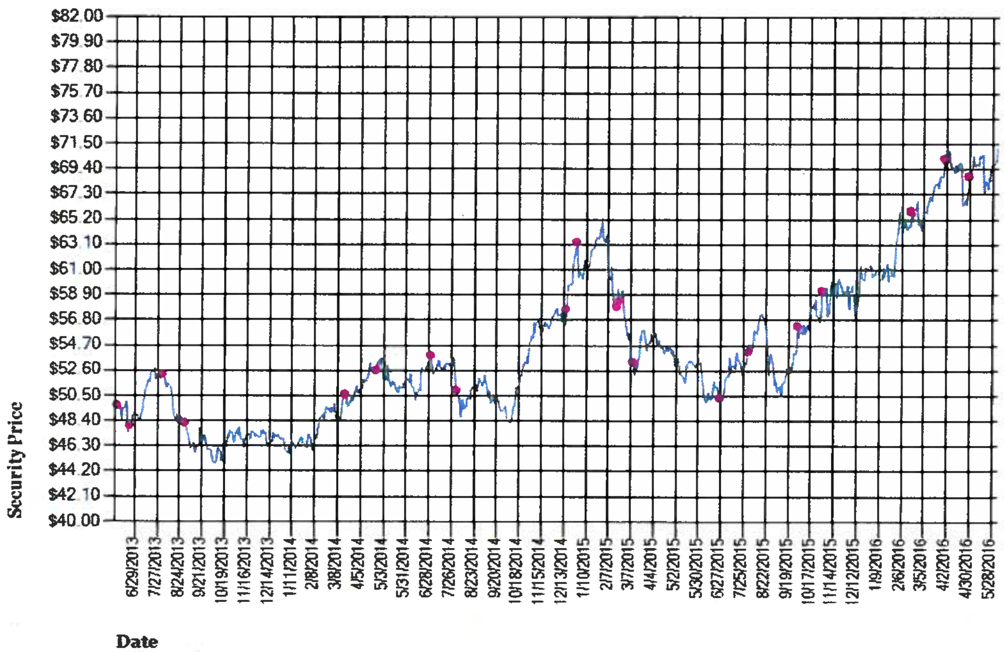
Sources: Factset & Wells Fargo Securities, LLC estimates

Company Description:

Headquartered in Cayce, South Carolina, SCANA's businesses include regulated electric and natural gas utility services, gas transmission and retail gas and energy marketing. The company's primary subsidiary, South Carolina Electric and Gas (SCE&G), serves 688,000 electric utility customers and 325,000 natural gas customers in central, southern, and southwestern portions of South Carolina. Public Service North Carolina serves 500,000 natural gas customers in north, central, Piedmont, and western parts of North Carolina. SCG is also involved in retail natural gas marketing in Georgia and wholesale energy marketing in the Southeast.

Required Disclosures

SCANA Corporation (SCG) 3-yr. Price Performance



	Date	Published Price ($)	Rating Code	Val. Rng. Low	Val. Rng. High	Close Price ($)
	6/4/2013		Kalton			
	6/4/2013	NA	1	57.00	58.00	50.32
•	6/6/2013	49.63	1	55.00	56.00	49.65
•	6/24/2013	48.15	1	54.00	55.00	47.96
•	8/2/2013	52.19	1	58.00	59.00	52.22
•	8/30/2013	48.10	1	54.00	55.00	48.12
•	3/17/2014	50.59	1	59.00	60.00	50.59
•	4/24/2014	52.56	1	60.00	61.00	52.56
•	6/30/2014	53.65	1	63.00	64.00	53.81
•	8/1/2014	50.88	1	60.00	61.00	50.86
•	12/16/2014	57.67	1	64.00	65.00	57.64
•	12/29/2014	62.27	1	69.00	70.00	63.18
•	2/17/2015	57.80	1	64.00	65.00	57.80
•	2/20/2015	58.27	1	63.00	64.00	58.30
•	3/9/2015	53.26	1	61.00	62.00	53.26
•	6/25/2015	50.70	1	57.00	58.00	50.22
•	7/30/2015	54.08	1	60.00	61.00	54.08
•	9/30/2015	55.12	1	61.00	62.00	56.26
•	10/30/2015	59.38	1	66.00	67.00	59.22
•	2/18/2016	65.80	1	73.00	74.00	65.80
•	3/31/2016	70.15	1	77.00	79.00	70.15
•	4/29/2016	67.81	1	74.00	76.00	68.69

Source: Wells Fargo Securities, LLC estimates and Reuters data

Symbol Key
- ▼ Rating Downgrade
- ▲ Rating Upgrade
- ● Valuation Range Change
- ◆ Initiation, Resumption, Drop or Suspend
- ■ Analyst Change
- ❐ Split Adjustment

Rating Code Key

1	Outperform/Buy	SR	Suspended
2	Market Perform/Hold	NR	Not Rated
3	Underperform/Sell	NE	No Estimate

Additional Information Available Upon Request

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As of: June 5, 2016

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